# Independent Financial Advisers Professional Indemnity Insurance Market Investigation

## The 2016 Survey of Leading IFA PI Insurers

CONTENTS



PROTEAN RISK

# Executive Summary

## Survey methodology

Protean Risk has completed a survey of the Professional Indemnity (PI) Insurance market for Independent Financial Advisers (IFAs). Underwriters involved in the IFA PI Insurance sector were invited to provide their personal opinion about the market outlook, to share their insights about emerging claims trends and to identify which risk management measures encouraged them to provide the most competitive PI Insurance terms.

An independent marketing consultancy was commissioned to manage the online survey, as this provided anonymity and gave comfort to underwriters that they could be forthright and honest.

We estimate that 10 insurers underwrite 90% of IFA PI risk in the UK market. The survey respondents consisted of a mix of these insurers, including those that have been involved in the sector for over 10 years along with relatively new players, all displaying a variety of different strategies and approaches. These vary from exclusivity with a single broker, those working with selected brokers only, and those that adopt an 'open door' policy for a particular profile of IFA.

This is the first time for several years that a survey of this nature has been conducted and it provides a valuable insight into the current underwriting environment of the IFA PI Insurance market.

**The objectives**

PI Insurance is, of course, a compulsory purchase for IFAs. It provides insurance protection in the event of an allegation of professional negligence that causes a client to suffer financial loss, such as an error, omission or giving poor advice. PI Insurance continues to be one of the single largest business expenses for IFAs, but it has far-reaching implications beyond just the cost of the premium. Exclusions and excesses can have a significant impact on the profitability and competitiveness of a firm.

As a specialist broker for the sector, one of our main goals is to help IFAs understand how they can better protect their businesses from PI claims, make more informed risk management investment decisions, and secure the most competitive insurance premiums. This survey contributes toward these goals.

## Key discussion points

- **Claims frequency remains a key concern for underwriters**
  Both the impact of the financial crisis finally receding and increased risk controls within IFAs are viewed as positive factors in reducing claims. On the other hand, an increasingly litigious environment, pension freedoms and the potential of further thematic reviews by the FCA were reasons that many of the respondents expected that there will be an increase in notifications during the next 12 months.
- **The need to be aware of the impact of dealing with certain activities and 'insistent clients'**
  PI premium rates are sensitive to business activities. Certain business activities are prime focal points for underwriters which include pension transfers, tax mitigation products and Unregulated Collective Investment Schemes (UCIS), as well as the transacting of 'insistent client' business. It is worth taking the time to understand how certain activities impact insurance premium, as these may ultimately prove unprofitable. Taking a clear direction and putting structures in place when advising on higher risk investments and 'insistent clients' appears to be good advice.
- **The value of strong risk management procedures remains high**
  Compliance structure, increased adviser oversight and file checking are high on the underwriter's checklist.
- **New PI Insurer market entrants expected**
  The question is whether this new capacity will target clean, low risk firms or perhaps seek to attract firms undertaking higher risk activities which, at the same time, demonstrate strong risk management systems.
- **Growing trend for non-renewal**
  This has significant implications for IFA firms, especially those engaged in higher risk activities or with a poor claims history and for those using single insurer market option brokers. Through taking the time to build relationships and possibly meeting a potential new insurer, IFAs should be able to take comfort that they have credible options at renewal and will also be in the best position to take advantage of any new insurance market capacity.

**Julian Brincat**

*Head of IFA Practice*

# Market Outlook

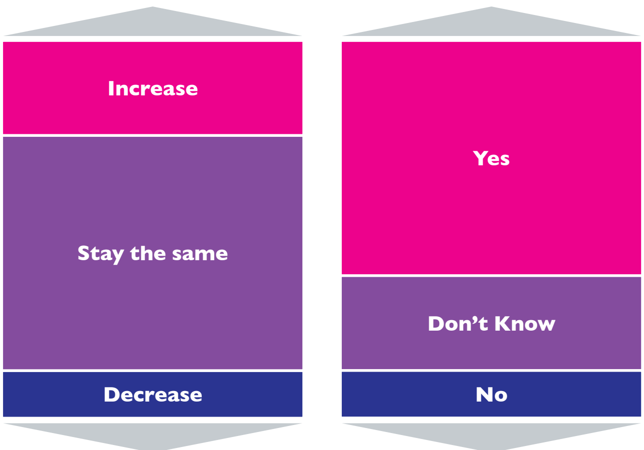
## Competition expected to rise

In recent years, arranging suitable and consistent PI Insurance has been somewhat of a roller coaster ride for many in the IFA sector. There had been a number of established insurers withdrawing from underwriting the sector, which in turn led to a significantly reduced capacity. In more recent times there have been new entrants, all offering varying levels of coverage with some offering highly competitive premiums.

Unfortunately, many insurers remain unenthusiastic about underwriting IFA PI due to the claims severity and frequency, the historic perception of poor risk management, and recent Financial Ombudsman Service (FOS) decisions. In addition, the general approach of the FCA has driven up the costs and exposures faced by insurers, such as their use of Section 166 and past business reviews which are perceived as heavy-handed measures. This has meant that part of the constant challenge for brokers in the sector is to encourage insurers to compete and offer compelling terms and levels of coverage. Could this now be changing?

**Will the number of IFA PI claims increase or decrease?**

**Will new insurers enter the market in the next 12 months?**




### New entrants and PI premium expectations

When underwriters were asked about competition and premium rating expectations, two clear camps emerged. Twice as many of our respondents felt that new insurers are preparing to enter the market than those that believed that the options would remain unchanged. This could have influenced thoughts about market rates with the same respondents suggesting that rates would remain stable as a result. None of the respondents felt that rates would decrease over the next 12 months for the sector as a whole.

### What type of firm would new entrants target?

The question is yet to be answered as to whether any new entrants will target clean, low risk firms or perhaps seek to attract firms with a strong risk management system undertaking higher risk activities.

Targetting clean, low risk firms can be an attractive option as they are often found to be paying a higher rate than they should be due to the rigid rating models used on facilities or schemes. Firms pursuing higher risk activities generally pay higher rates. To target these types of firms new insurers would need to employ underwriters with strong IFA experience in view of the enhanced risk complexities at this end of the market.

# Market Trends

## Trend towards non-renewal

Over the past 12 months we have observed a growing trend of prospective clients approaching Protean Risk having been told that their existing insurers are unable, or unwilling, to offer terms. The results of the survey confirmed our experience with each of the underwriters confirming that they had not offered renewal terms to one or more of their IFA clients in the past 12 months.

The respondents ranked their most common reasons for non-renewal of an IFA firm as:

| Reason for non-renewal | Ranking in terms of importance |
|---|---|
| Poor claims record | 1 |
| Existing or growing pension transfer exposures | 2 |
| Non-disclosure of material information | 3 |
| Lack of underwriting information | 4 |
| Continued involvement in high risk activities | 5 |
| Change of business blend | 6 |
| No longer desirable to the scheme/facility | 7 |

The spectre of non-renewal has significant implications for IFA firms, who cannot trade without PI coverage. We would recommend that firms involved in pension transfer work and other higher risk activities, or those with a poor claims record, engage with their broker early. It is essential to agree a structured marketing plan for the submission to underwriters and also to ensure that all relevant data is readily available.

A number of brokers specialising in the IFA PI sector are limited to a single insurer option, usually by way of a tied arrangement (commonly known as a 'scheme' or 'facility'). Whilst schemes and facilities can produce very reasonable premiums, they are often achieved through the adoption of rigid underwriting parameters which can be liable to change.

In our experience, certain activities which now appear on the underwriter's radar as 'higher risk' could result in an IFA falling outside of the rigid parameters, potentially resulting in a forced broker change late on in the renewal cycle. We would strongly recommend that IFAs using a single-market insurance broker seek early alternative options, especially if they are undertaking activities which insurers perceive to be higher risk such as tax mitigation investments and Defined Benefit (DB) pension transfers.

Through taking the time to build those relationships and possibly meeting a potential new insurer, IFAs should be able to take comfort that they have credible options and will be in the position to take advantage of any new insurance market capacity. A 'one size fits all broking approach' may continue to work for some firms but the last minute challenges it could create are undesirable at best.

> "We have observed a growing trend of prospective clients approaching Protean Risk having been told that their existing insurers are unable, or unwilling, to offer terms."

# Claims Expectations

Almost two thirds of those surveyed expect claims notifications to increase in 2016. On one hand, many underwriters recognised the impact of the financial crisis finally receding and increased risk controls within IFAs as a positive factor in reducing the potential of claims. On the other, an increasingly litigious environment, pension freedoms, and the potential for further thematic reviews by the FCA, were the main reasons that many of the respondents felt that there will be an increase in notifications over the next 12 months.

When asked to highlight the risk areas which concerned them most, the answers centred around four key issues that are discussed in this section. It was interesting to note that client/adviser ratio, lack of compliance resource and legacy risk did not figure, although these are limited to an individual IFAs set-up compared with industry-wide issues.

## Risk areas which most concern insurers

### Tax mitigation and UCIS

Tax mitigation schemes and Unregulated Collective Investment Schemes (UCIS) have been, and continue to be, a significant concern for insurers with the majority of severe claims emanating from these areas.

As a result, large numbers of policies today seek to exclude UCIS on a wholesale basis, others on a named basis. It is still possible to obtain coverage for UCIS advice, helped if the IFA can demonstrate that it was promoted correctly and holds accurate data showing its historic performance.

Arguably the bulk of exposure is now historic as the industry recovers from issues connected with insolvent or suspended funds from prior to 2011.

### Insistent clients

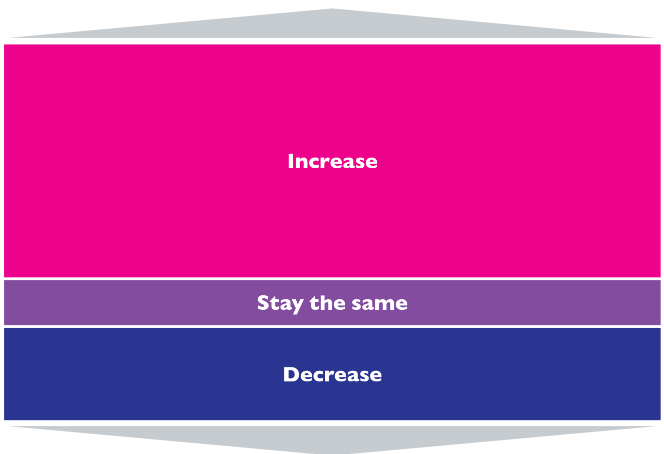
The current issue of 'insistent clients' is largely connected to DB pension transfers and is as much of a concern as conducting higher risk activities in some cases. Of course, the pension freedoms have clearly brought this subject to the fore and likewise onto the underwriters' radar. In fact nearly one in three advisers will advise and transact DB pension transfers for insistent clients, according to a recent Financial Advice Market Review (FAMR) survey. This has resulted in the appearance of more 'insistent client' questions on insurers' proposal forms in the last 12 months.

Insurers' main concerns stem from the potential of future sanctions eminating from either the FCA, the FOS and particularly claims firms. This has led to the potential of an increase in PI costs as well as the threat of withholding cover altogether at some future point. The FCA published a factsheet with a three step process on how to deal with insistent clients in June 2015.

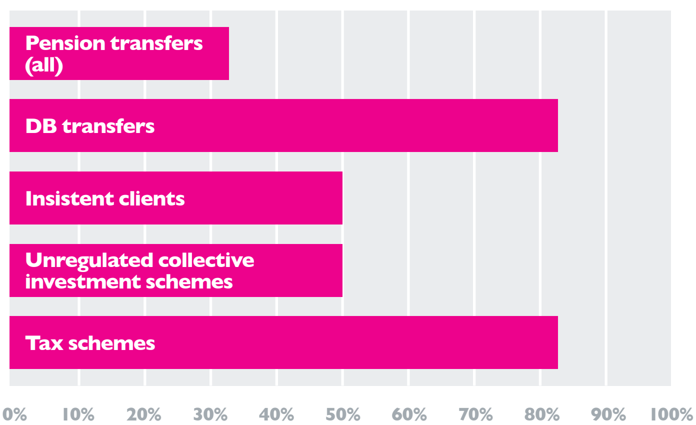
1. Provide advice that is suitable for the individual client. This advice must be clear to the client.
2. Be clear to the client that their actions are against the IFAs advice.
3. Be clear with the client what the risks of the alternative course of action are.

This guidance note has been criticised for not allaying advisers' concerns, especially as the FOS has recently stated that following these steps will not guarantee that a future FOS review of the advice would be necessarily avoided.

**Expectation of IFA PI claims notifications in the next 12 months**




**Percentage of respondents giving their top three risk concerns**



**Pension transfers**

One of the rising key areas of concern is advice on pension transfers, particularly involving DB schemes, which have experienced a marked increase since the pension freedoms.

In March 2015, the FCA confirmed plans that savers in DB schemes can take advantage of the new pension freedoms, but would need to get prior advice from a pension transfer specialist. It is estimated that thousands of people per year will transfer out of their DB scheme and will need advice to do so.

The FCA has just undertaken a survey of firms on various areas of activity as part of the FAMR. This survey asked firms to provide information on the number of requests for DB to Defined Contribution pension transfers that they had received post-pension freedoms. The results show that the total number of requests had more than doubled from existing clients and more than trebled from new clients, compared with the equivalent period prior to the pension freedoms. This report shows that a large percentage of firms that had not previously conducted any DB transfers were now involved in this activity.

It is this step into the unknown which is causing insurers to adopt a very cautious approach when dealing with firms who give pension transfer advice. Insurers fear an increase in complaints stemming from this new rise in demand, along with the potential of claims management companies pursuing advisers, as we have seen in areas such as payment protection insurance (PPI) in recent years. Contributing to their fear is the fact that the FOS has a history of upholding complaints concerning advice on pension transfers and opt-outs.

Where IFAs can demonstrate that a DB transfer has been conducted in the clear best interest of the client (for example, a client wanting to take advantage of the inheritance tax benefits of being able to pass on a pension fund to his desendants) then insurers would look more favourably on offering or maintaining coverage. Again, as with insistent clients, maintaining information in a format that can be easily released to insurers at renewal will be essential.

> "The results show that the total number of requests had more than doubled from existing clients and more than trebled from new clients."

# Risk Management Measures

When asked which risk management measures have the most impact upon obtaining more competitively priced PI Insurance, there was a great deal of variation between respondents.

Clearly some of the issues from the previous sections were repeated, particularly around pension transfer exposures and insistent clients. Considering all the factors, they can be grouped into three key focus areas:

## 1. Business and client selection

A number of areas highlighted in the below table relate to the need to be selective over the nature and type of activities conducted, managing pension transfer activity and dealing with insistent clients. The survey demonstrates that the combination and nature of activities has clear implications with regard to premium levels, excesses, exclusions, conditions and the level of coverage an IFA can obtain going forward.

A broker should be able to advise upon the premium rating relating to particular activities, as it may transpire that these become unprofitable once PI cost implications and client suitability is taken into account.

Underwriters require a very strong case to be presented if cover is required for higher risk investments. It is very common that they will decline terms on the basis of these higher risk activities, insert specific exclusions, or at best agree to provide insurance, but with an increased policy deductible for claims arising from these areas.

Full disclosure to insurers is very important and should include individual investment amounts, products, performance to date, whether clients are sophisticated investors or high net worth, percentage of the overall portfolio that these investments constitute and confirmation as to whether they have been promoted in accordance with the Conduct of Business (COB) rules.

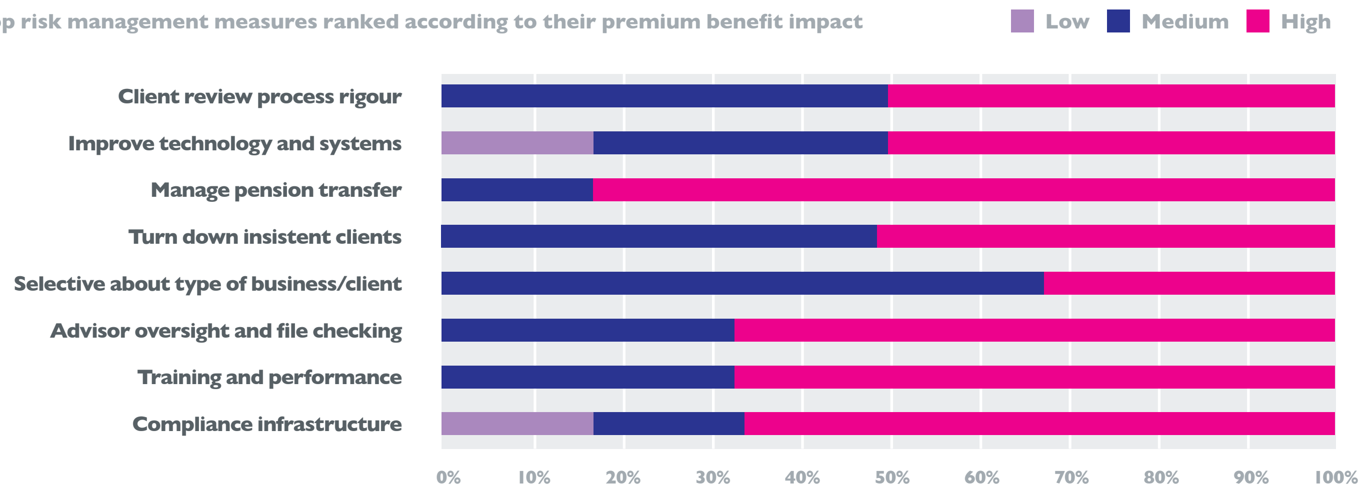
Again, it would help to be able to demonstrate the due diligence and procedures involved in promoting these investments as well the ability to provide samples of any client documentation (Attitude to Risk, Know Your Client, Risk Warnings etc.). The better the structures and documentation in place, the more they can be relied on to defend a claim should one arise. It may be stating the obvious, but a firm that has had any issues (such as claims or Section 166 Reviews) especially in any of these areas, will find it even harder to convince underwriters to offer cover unless they can fully demonstrate that they are unlikely to have a reoccurrence – which usually translates into clearly identifiable systemic risk management improvements.

Once the decision has been made to participate in higher risk activities it is imperative that the exposure is managed. DB transfers are currently at the top of insurers' list of concerns. Underwriters demand strong systems in place to control this exposure and have begun to request significantly more details on pension transfers than in previous years. They request and review comprehensive lists of transfers, especially those involving enhanced transfer values, including reasons for the individual transfer and critical yields. As this information can take a while to compile, it is worth ensuring the reporting systems are in place throughout the year so the detail can be provided at renewal.

IFAs can strengthen their risk presentation at renewal by including a sample of the documentation that they provide to a client including questionnaires and reports as well as giving a narrative on the overall client management and risk management process operated by the firm.

Finally, the preference of insurers is that insistent clients be avoided altogether, but if they are dealt with, then firms should follow the FCA guidelines as well as maintain a list and description of each case which can be made available to insurers on request at renewal. The ability to demonstrate this could be the difference between obtaining a quotation or being declined and having to seek terms elsewhere.

**Top risk management measures ranked according to their premium benefit impact**





## 2. Invest in compliance infrastructure

Client review processes, a culture of adviser oversight and file checking, robust technical and internal systems, and good quality compliance procedures all featured highly with the respondents as measures that can be taken to reduce risk.

For medium to high risk investments there should be a peer review system and internal sign off, as well as post-sale file audits. These should be conducted both internally and in conjunction with an external compliance provider in order to ensure that any issues are identified at an early stage. There should be a system of supervisory controls and review of all documents for all advisers, including senior members of the firm, and this should also extend to post-sale reviews.

The ability to demonstrate the existence of strong systems to identify, assess and control risk sends a very positive message to insurers. This involves having well-documented policies in place that all members of staff are familiar with. Any potential conflicts of interest should be minimised and controlled and a suitable risk register should be in place together with systems to manage risks.

The firm should have a documented compliance procedure with clearly laid out processes for advisory and sales roles in all areas of the business, as well as processes in place to report any complaints. Investing in the services of an external compliance provider which can conduct regular visits can also be a positive step.

Additional focus areas include the level of documentation such as signed Terms of Business Agreements which include a structured scope of services, Attitude to Risk and Know Your Client files, evidence in writing of all advice and instructions and that there is clear evidence on file to show that the client's entire portfolio has been considered.

## 3. Training and performance

All staff should be well qualified for the type of work which they are undertaking, reviewed on a regular basis by way of formal appraisal (for example) and provided with appropriate training.

Insurers evidently place a lot of importance on the training and qualifications of a firm's staff. This is considered, together with the experience of the staff and is viewed positively by underwriters as it normally indicates a higher set of standards within the firm. An IFA which is either a member of a quality group or network, a Chartered Firm or one with particularly well-qualified staff should be highlighting these facts to their broker in order to further reassure underwriters of the quality of their firm.

# Why Protean Risk?

Protean Investment Risks Limited is a specialist insurance broker advising firms and individuals in the investment industry, financial services and technology sectors.

Clients range from individuals through to companies with revenues in excess of £100m. We attract clients through our extensive knowledge, experience and our access to a comprehensive range of leading providers, from global insurers to niche specialists, ensuring that we can match our clients' requirements with the most appropriate insurer and wording.

Protean Risk is fast emerging as one of the leading IFA PI brokers in the UK with in excess of 80% growth in premium, year on year, since 2012. Unencumbered by the commitment to schemes and facilities, Protean Risk has access one of the widest available choices of IFA PI insurers including Lloyd's markets.

Protean Risk works closely with the Association for Professional Compliance Consultants (APCC) and has participated in insurance steering groups which have included the Financial Conduct Authority (FCA) and the Financial Ombudsman Service (FOS).

Underpinning our values as a company is an overarching focus on customer service and satisfaction, borne out by extensive client testimonials and client retention rate. During a recent client survey over 90% of respondents rated our service as 'good' or 'excellent' and recommended us as 'experts in their business sector'.

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